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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

CONTAINER CORPORATION OF AMERICA,

Appellant,

v.

FRANCHISE TAX BOARD,

Appellee.

ON APPEAL FROM THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE DISTRICT

BRIEF OF AMICUS CURIAE STATE OF ILLINOIS IN SUPPORT OF APPELLEE

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STATEMENT OF INTEREST

On April 19, 1982, oral argument was heard in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., Illinois Department of Revenue*, et al., No. 81-349. On May 3, 1982, that case was restored for reargument, and probable jurisdiction was noted in the instant matter. In both of these cases a state has imposed a privilege or income tax measured by apportioning the combined incomes of domestic and foreign corporations. Since a decision in this case on either the unitary nature of Container's business, the due process argument regarding distortion of income, or the foreign commerce clause implications of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434

(1979), could have an impact on the ultimate decision in *Chicago Bridge & Iron* and, since this *amicus curiae* is a party in *Chicago Bridge & Iron*, it is submitted that this *amicus curiae* has a significant interest in the disposition of this case.

SUMMARY OF ARGUMENT

The threshold issue in this case is the last issue raised by Container. It is whether Container and its subsidiaries conducted a unitary business. If they did not, combined apportionment is not the appropriate method of state taxation, and this Court does not need to reach any constitutional issues. For the reasons stated by the lower court, Container and its subsidiaries did conduct a unitary business. The "substantial flow of goods" test suggested by Container should be rejected since it is an attempt to legislate in an area which should be considered on a case-by-case basis. Container has not shown that its California activities did not contribute to and depend on the flow of information, expertise and funds among the parent and its subsidiaries. Nor has Container shown that the income attributable to California is not rationally related to its intrastate values.

The distortion of income and double taxation arguments are premised on the validity of separate accounting. Consequently, they are not, in and of themselves, reasons for prohibiting the use of combined apportionment to attribute the income earned by a unitary business. If combined reporting does not cause extraterritorial taxation, then it cannot cause double taxation. Since combined reporting does not violate either a statute or a treaty of the United States, it does not prevent the United States from speaking with one voice.

ARGUMENT

I.

WHETHER A UNITARY BUSINESS EXISTS SHOULD BE CONSIDERED ON A CASE-BY-CASE BASIS, AND THE FINDINGS OF THE COURT OF APPEAL SHOULD BE UPHELD.

The unitary-business principle has been a familiar concept in tax cases for over 60 years. *ASARCO, Inc. v. Idaho State Tax Commission*,[1] 102 S.Ct. 3103, 3111 fn. 14. "[T]he application of the unitary-business principle requires in each case a careful examination . . . of the way in which the corporate enterprise is structured and operates. . . ." *Id.*, at 3115 fn. 22.

Container has asked this Court to abandon this case-by-case analysis and to adopt a "bright line" test whereby there must be a "substantial flow of goods" in order for a manufacturing or mercantile enterprise to be considered unitary. Appellant's Brief p. 47. This request should be rejected since it is an insufficient test and it is a call for judicial legislation.

One practical reason why the test is insufficient is that it would implicitly overrule *Butler Bros. v. McColgan*, 315 U.S. 501 (1942). In that seminal case, centralized purchasing was found to result in more favorable prices than if the purchases were separately made by each branch store. "[T]he central buying division alone demonstrates that functionally the various branches are closely integrated." 315 U.S. at 508. The purchased goods were shipped directly from the various manufacturers, and there was no flow of goods between or among the central office and the outlying branch operations.

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[1] A Petition for Rehearing is pending.

Previous requests have been made for this Court to promulgate a "test," based on prior case law, in order to make it easier to determine when a partnership exists and when a transfer amounts to a "gift," *Commissioner v. Culbertson*, 337 U.S. 733 (1949); *Commissioner v. Duberstein*, 363 U.S. 278 (1960). These requests were unequivocally rejected.[2] Just as all the relevant facts must be considered in order to determine whether a partnership exists or whether a gift has been made, a similar inquiry is necessary to determine the existence and contours of a unitary business. Thus, while a substantial flow of goods can be an important characteristic of a unitary business, it is not the *sine qua non* of combined apportionment.

The Court of Appeal reviewed the factual record and found that Container and its subsidiaries operated a unitary business. So long as there is a factual foundation in the record to support this finding and in the absence of "exceptional circumstances," the lower court's findings

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[2] In *Culbertson*, the Commissioner argued that the contribution of either "vital services" or "original capital" was essential to membership in a family partnership. The Court stated:

> Use of these "tests" of partnership indicates, at best, an error in emphasis. It ignores what we said is the ultimate question for decision, namely, "whether the partnership is real within the meaning of the federal revenue laws" and makes decisive what we described as "circumstances [to be taken] into consideration" in making that determination. (footnote omitted). 337 U.S. at 741.

In *Duberstein*, the Commissioner asked the Court to promulgate a new "test"—namely, that gifts should be defined as transfers of property made for personal as distinguished from business reasons. The Court stated:

> We reject this invitation. We are of opinion that governing principles are necessarily general and have already been spelled out in the opinions of this Court, and that the problem is one which, under the present statutory frame-work, does not lend itself to any more definitive statement that would produce a talisman for the solution of concrete cases. 363 U.S. at 284-85.

should not be reversed. *Evco v. Jones*, 409 U.S. 91, 95 (1972); *Cal. Retail Liquor Dealers Ass'n. v. Midcal Alum.*, 445 U.S. 97, 112-13 (1980); *Fry Roofing Co. v. Wood*, 344 U.S. 157, 160 (1952). The Court of Appeal found that there was a unity of ownership, use and operation between Container and its subsidiaries. J.S. at A-15. It further found that the business conducted within California was dependent upon or contributed to the operation of the business outside the state. J.S. at A-16. These conclusions were based on evidence that Container "assisted its subsidiaries in procuring paper, personnel and equipment" and that the "interchange between parent and subsidiaries in the areas of technical assistance, development and management policymaking is significant." J.S. at A-9 and A-16. The Court noted that Container constantly reviewed the financial reports of its subsidiaries; that it exerted control at the highest levels through its participation on the boards of directors of the subsidiaries and through the activities of the "foreign operations staff;" that the technical assistance was substantial; that the amounts of loans and guarantees were substantial; and that the annual reports showed that Container's self-image and the image it projected was that its worldwide activities constituted a single, unified business. J.S. at A-4, A-13 and A-15. All of this reflects a significant flow of information, expertise and funds between parent and subsidiary, and the application of this information, expertise and funds to the production of paperboard packaging contributes to the profitability of Container's operations in California.

Container compares its operations with those present in *F.W. Woolworth v. Taxation and Revenue Dept.*, 102 S.Ct. 3128 (1982), petition for rehearing pending, and draws the conclusion that it does not operate a unitary business with its foreign subsidiaries. The analogy is not sound. Woolworth conducted a retail merchandising business. Container engaged in the production and

distribution of paperboard packaging. A major difference between these two businesses is that the latter requires technological expertise at the production stage. This technological expertise was transmitted to Container's subsidiaries on a continuing basis through the technical service agreements, the sale and assistance in purchasing equipment, and the interchange of a small number of presumably well-chosen employees. J.A. 74-77; J.A. Exhibits 9-33. In addition, Container was significantly more active in the management of its subsidiaries than was Woolworth. This is evidenced by the larger foreign operations staff, the larger number of interlocking directors, the regular review of financial reports, and the substantial amount of loans or loan guarantees. J.A. 65-73. The foreign subsidiaries should not be considered discrete business enterprises in light of this continuous flow of technological expertise and management of activities.

II.

COMPARISONS OF WAGE RATES AND RATES OF PROFITABILITY CANNOT BE USED TO INVALIDATE COMBINED REPORTING AS A METHOD OF INCOME ATTRIBUTION.

Container's principal argument on the law is that combined apportionment violates the due process clause because the lower wage rates and allegedly greater profitability of foreign operations distort income attribution and produce extraterritorial taxation. Appellant's Br. pp. 11-26. This raises the question whether a difference in wage rates and rates of profitability constitute a proper basis for attack on the constitutional validity of combined apportionment. Combined apportionment is a method of income attribution which is used when two or more corporations conduct a unitary business. Therefore, the question may be stated more precisely as whether a difference in wage rates and rates of profitability in various geo-

graphic areas can be used to attack a method of attributing the income of a unitary business. For a simple reason, it cannot. Comparisons of wage rates and rates of profitability in different geographic areas are necessarily premised on notions of separate accounting. The unitary-business principle is a result of the inability to account separately for the income earned from interrelated business activity. Thus, it defies logic to oppose the unitary-business principle by recourse to the discredited separate accounting theory or any of its derivatives. At the most, separate accounting may be used to attack the reasonableness of an apportionment result in a particular case, but it cannot be used to invalidate apportionment as a method of taxation. See *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931).[3]

The initial premise in Container's argument is that "Combined apportionment under the unitary method assumes that a dollar of property, payroll and sales of the parent (Container) produces approximately the same

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[3] The Due Process Clause requires that the income attributed to the state be rationally related to the intrastate values. The unitary-business principle is one way to establish this relationship. *Mobil*, *supra*. Until *ASARCO*, *supra* and *Woolworth*, *supra*, another way was the "business income" test—namely, whether the intangible property producing the income was acquired and managed as an integral part of the business conducted, in part, in the taxing state. For another view, see Lathrop, *Due Process Considerations and the Apportionment of Dividend Income: A Dissent from the* ASARCO and WOOLWORTH *Decisions*, TAX NOTES, p. 3, July 5, 1982, wherein the author submits that the linchpin of apportionment is not the unitary-business principle; it is the reasonableness of the result. Under *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940), the linchpin is "whether the amount of net income attributed to the state has a rational relationship to the business activities carried on by the corporation in that state for which the state has given benefits and can ask compensation in return." *id.*, p. 20. Under this test, neither the unitary-business principle nor the "business income" test is necessary to determine a violation of due process.

amount of income as a dollar of property, payroll and sales of a subsidiary." Appellant's Br. p. 11. It then asserts that the wage rates and rates of profitability of its foreign subsidiaries, and of foreign subsidiaries in general, are significantly different from those of domestic corporations. Since these differences are not taken into account under combined reporting, it argues, the attribution of income is distorted, and this results in extraterritorial taxation and double taxation.

The error in Container's argument is that it ignores the unitary-business principle and it relies instead on factors which are totally irrelevant if a unitary business exists. In effect, the argument begs the question. Container's premise—that combined reporting assumes that a dollar of property, payroll and sales is equally profitable wherever situated—is a comment on how the method operates.[4] It is not relevant to the reason why the combined report is used. An attack on how an apportionment method operates is an attack on the application of the method. It is a request for relief. It is not an attack on the facial validity of the method. It does not undercut the appropriateness of apportioning the income of a unitary business. Even Hellerstein and Hellerstein, *State and Local Taxation*, 539 (4th ed. 1978), admit that this argument relates only to the issue of relief from formulating apportionment.

The reason why the combined report is used is that, if a unitary business exists, it is misleading to characterize the income earned by that business as having a single, identifiable "source." See *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438 and 440-41.

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[4] Chicago Bridge & Iron and the Solicitor General each rely on this same assumption about combined reporting. Brief of Appellant at 11, 36 and 41, and Memorandum For The United States As Amicus Curiae at 13, *Chicago Bridge & Iron, supra*.

Consequently, the appropriateness of the combined report depends on whether a unitary business exists or whether several discrete business enterprises exist. None of the relevant cases indicate that a difference in wage scales has any bearing on whether one corporation is "separate and distinct" from another corporation or whether the two are "related." See *Mobil, supra*; *John Deere Plow Co. of Moline v. Franchise Tax Board*, 238 P. 2d 569 (1951), appeal dismissed 343 U.S. 939 (1952); Brief for Appellant at 33, *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924). Nor does a difference in the rate of profitability have any bearing on this issue. See *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207 (1980); *Butler Brothers v. McColgan*, 315 U.S. 501 (1942).

The fact that Container has presented nothing more than a separate accounting analysis is evidenced by the numerous references to separate accounting as its standard of comparison. Appellant's Br. pp. 13-18, 21-22.

Container illustrates its argument by posing an example of one company located in Columbia which operates at a profit and a second company located in California which operates at a loss. Appellant's Br. p. 15, note 4. It contends it is unfair to use a combined report in this situation because one half of the income earned in Columbia would be attributed to California. Leading commentators have already answered this hypothetical:

> The idea that a company might sustain losses from business transactions in certain areas and realize profits from other business transactions in other areas is commonly held and is fully in accord with what may be referred to as conventional conceptions of source of income. But such conventional conceptions are both archaic and myopic. A broader conception of unity is needed to keep pace with the increasingly complex commercial, industrial and financial world. (footnote omitted.) Keesling and

Warren, *California's Uniform Division of Income for Tax Purposes Act*, pt. 1, 15 UCLA Law Review 156, 172 (1967).

Among other things, Keesling and Warren suggest that the ownership of numerous operations, some of which will operate at a loss at any given time, is necessary in order to protect against the effects of market uncertainty. *id.*

The question posed by appellant is whether worldwide combined reporting is repugnant to the Due Process and Foreign Commerce Clauses. The litigation strategy has been similar to that employed in *Mobil*, 445 U.S. at 434, wherein Mobil challenged the tax base rather than the fairness of the formula. Appellant does not seriously argue that it is entitled to relief from an otherwise valid method of formulary apportionment. Yet the reasons relied on by appellant, differences in wage rates and rates of profitability, at most relate to the fairness of the apportionment formula rather than the constitutional validity of combined reporting. These reasons relate to the application of combined reporting rather than the reasons for its use. Thus, appellant has not shown that the use of a combined report to apportion the income of a unitary business is invalid as a constitutional matter.

III.

SINCE DOUBLE TAXATION IS A COROLLARY TO EXTRATERRITORIAL TAXATION, COMBINED REPORTING DOES NOT CAUSE DOUBLE TAXATION FOR THE REASONS STATED ABOVE.

In its argument with respect to the Due Process Clause, Container asserted that the combined reporting method attributed almost $4 million more per year to the United States than the arms-length method did. Appellant's Brief p. 17. It claimed that if California taxed any part of

this $4 million, that would be extra-territorial taxation. Appellant's corollary to this point is that foreign countries can and do tax this same income, and this results in double taxation in violation of one of the two precepts enunciated in *Japan Line, supra.*

For the reasons stated above, appellant has not shown that combined reporting attributes to California any more income than is earned there. Since Container operates a unitary business, it is a mistake to rely on separate accounting and to characterize certain income of the business as having a single identifiable source in a foreign country. Just as combined reporting does not automatically cause extraterritorial taxation, even when it includes corporations which operate in foreign countries, it does not automatically cause double taxation.

IV.

COMBINED REPORTING DOES NOT PREVENT THE UNITED STATES FROM 'SPEAKING WITH ONE VOICE'.

Combined reporting does not violate either a statute or a treaty of the United States. For almost 20 years Congress has considered legislation which would regulate state taxation of income. *Mobil*, 445 U.S. at 448. Current proposals would prohibit the States from using worldwide combined reporting. S.655, 97th Cong.; H.R. 1983, 97th Cong. Congress has not passed this legislation. Article 9(4) of the U.S./U.K. Treaty would also have prohibited the use of combined reporting insofar as those signatories were concerned. However, the U.S. Senate ratified the treaty only after that prohibition was excluded. This would have been a useless act if current treaties implicitly contained that prohibition.

The fact that an international standard of taxation does not exist is further evidenced by the lack of an

international administration to enforce this standard. When a corporation sells a product or sells a service, or loans money to an affiliated corporation, a determination must be made as to the "arms-length" character of the transaction. In the course of a year, millions, if not billions, of these transactions are made at different levels within the corporations and at different geographical locations. A state auditor may disagree with the estimate of the taxpayer on many of these transactions. A federal auditor may disagree with both the taxpayer and the state auditor. Auditors from foreign countries may disagree with each other as well as with the taxpayer, the state auditor and the federal auditor. Thus, instead of speaking with one voice, these transactions bring forth a babble of voices. Simply put, there is no international standard of taxation, and neither California nor any of the other states have prevented the United States from speaking with one voice on this matter.

CONCLUSION

For the foregoing reasons, *Amicus Curiae* State of Illinois respectfully requests this Court to affirm the decision of the Court below.

Respectfully submitted,

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